



ANNUAL REPORT 1973





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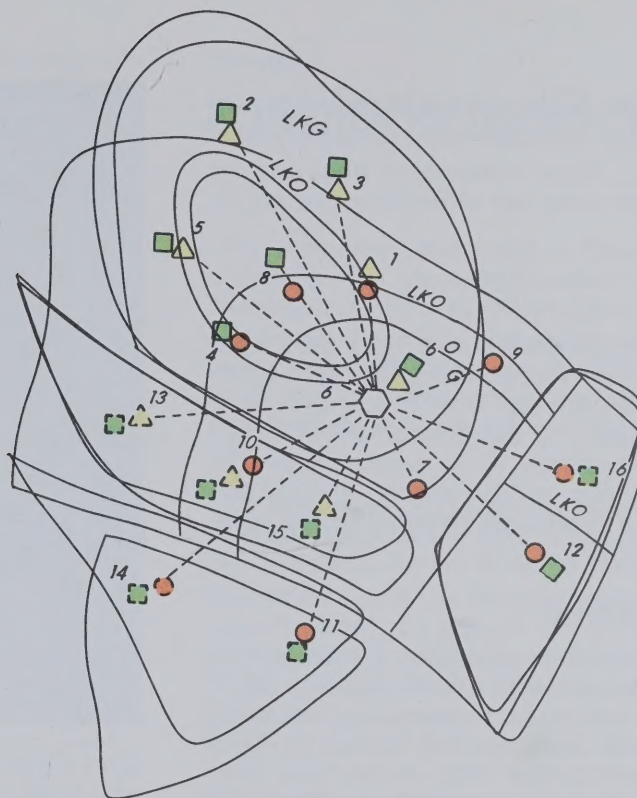
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The Front Cover: Mesa's Eugene Island Block 330 with one production platform and two of three drilling platforms.

The Annual Meeting of Shareholders of Mesa Petroleum Co. will be held at the LaCasita Room, Holiday Inn I-40, 1911 Interstate Highway 40, Amarillo, Texas at 10:00 A.M. on Wednesday, May 22, 1974.

Highlights



Development plan for offshore Gulf of Mexico tract

	1973	1972	1971	1970	1969
FINANCIAL					
Revenues	\$141,864,000	\$ 97,445,000	\$ 91,623,000	\$ 52,530,000	\$ 32,428,000
Funds provided from operations	\$ 27,883,000	\$ 27,052,000	\$ 22,515,000	\$ 13,891,000	\$ 13,874,000
Income before extraordinary items ..	\$ 19,104,000	\$ 16,652,000	\$ 14,711,000	\$ 9,060,000	\$ 10,406,000
Net income	\$ 19,104,000	\$ 16,652,000	\$ 14,711,000	\$ 8,806,000	\$ 10,680,000
Earnings per common and common equivalent share before extraordi- nary items	\$1.75	\$1.55	\$1.39	\$.90	\$1.05
Total assets	\$353,395,000	\$221,024,000	\$135,011,000	\$113,650,000	\$110,517,000
Stockholders' investment	\$185,631,000	\$ 95,341,000	\$ 79,880,000	\$ 61,396,000	\$ 54,744,000
OPERATING					
Net production (after royalty)					
Oil and condensate (bbls.)	1,531,552	1,363,771	1,560,188	1,864,767	1,917,233
Natural gas liquids (bbls.)	1,345,733	1,530,127	1,319,519	688,041	688,932
Natural gas (Mcf)	98,798,119	92,470,862	84,538,926	56,826,200	53,610,112
Undeveloped acreage					
Gross acres	10,083,620	10,763,449	6,804,322	7,285,414	6,908,449
Net acres	5,400,042	5,173,286	3,851,646	4,154,784	3,517,182

To Our Shareholders

The Company's activities during 1973 were highlighted by 1) very successful exploration results, 2) a major participation in the offshore Texas Federal lease sale, 3) the acquisition of Pubco Petroleum Corporation, 4) an equity offering of approximately two million shares of common stock, and 5) a continuing trend of record revenues and earnings.

Results of Operations

Net income for the year ended December 31, 1973 rose to a record high of \$19,104,000 or \$1.75 per common and common equivalent share, an increase of 15% over the \$16,652,000 or \$1.55 per share for 1972. The 1972 results have been restated to reflect the acquisition of Pubco Petroleum Corporation in April 1973 on a pooling-of-interests basis. Revenues for the year also reached record levels of \$141,864,000 compared to \$97,445,000 in the previous year, a rise of 46%. While the Agro Division's net operating income of \$4,176,000 was below 1972 earnings of \$6,357,000 due to a \$4,496,000 inventory adjustment to reflect lower cattle prices, the Petroleum Divisions' net operating income rose \$2,637,000 to \$18,737,000 due to increased production of natural gas, crude oil and condensate coupled with improved prices. Approximately 82% of net operating income, before general and administrative expenses and Federal income taxes, was derived from oil and gas operations, while 18% was contributed by the agribusiness operations.

Exploration and Development

The Company's exploration and development activities were expanded in all divisions during the year. Mesa participated in drilling 90 exploratory wells and 138 development wells, resulting in 42 successful exploratory wells and 106 successful development wells for a combined 65% success. The exploratory successes in all divisions provide Mesa with an unusual number of development locations to be drilled during 1974 and subsequent years. A number of drainage tracts in the Gulf of Mexico, offsetting leases in which Mesa holds interests, are scheduled for the March and May Federal lease sales. The information obtained from our exploratory and development activities



gives Mesa and its partners an important bidding advantage for these drainage tracts and will perpetuate our participation in future Federal offshore lease sales.

As a result of our 1973 drilling activities, we estimate that 5 million barrels of oil and condensate and 200 billion cubic feet of gas have been added to the Company's proved reserves. These additions do not include reserves from offshore tracts. Significant new oil production in 1974 will come from the Garrington field in Alberta, the Hoosier area in Saskatchewan, the North Shoe Bar field in New Mexico, and the Steinle Ranch Unit in Wyoming. Increases in gas production are expected from the West Newcastle area and the Trader's Creek field in Oklahoma, the Southeast Carlsbad area in New Mexico, High Island 22-L, in State waters offshore Texas, and from the Lavo area in Alberta.

The Company's strategic spread of undeveloped leases from Canada to the Gulf of Mexico was the key factor in the outstanding drilling results of 1973. Acquisition and maintenance of a strong acreage position continues as one of our primary objectives, and we believe our present inventory of 5.4 million net acres is of excellent quality. Mesa expended \$70 million for acreage purchases in 1973; about \$64 million of these lease expenditures went toward acquiring an average 14.5% interest in 14 tracts offshore Texas in the June 1973 Federal offshore lease sale. Through February 1974, 16 exploratory wells had been drilled on seven of these tracts. Hydrocarbons were encountered on five of the tracts. Platforms are under consideration for three of

these tracts; however, additional exploratory drilling on the other two tracts will be necessary to determine if development is justified.

In March 1974, Mesa agreed to invest \$3.9 million over a two-year period to acquire a 19% interest in Sunlite Oil Company Limited. Mesa also received a one-year option to acquire additional stock to bring its interest to 55%. Sunlite has important leasehold positions in the North Sea, the Arctic, Canada and the United States.

Our nation's energy vulnerability has been forcibly brought to the attention of every U.S. citizen this past winter as a result of the reductions of available crude oil from the Middle East. The warnings voiced in past years by spokesmen for the petroleum industry went unheeded, and it would be a mistake to allow skepticism or consumerism to prevent or even postpone the establishment of a national energy policy incorporating long-range incentives for exploration and development of petroleum and other energy resources. An ample, uninterrupted supply of energy is critical to the entire economy, and timely resolution of appropriate policies under which the energy companies are to operate is needed.

Agribusiness

Cattle prices fluctuated widely during 1973 in reaction to consumer boycotts, retail meat price ceilings, and rapidly rising feed costs. Although the year was filled with uncertainties for the cattle-feeding industry, the Agro Division earned \$4,176,000 in net operating income compared to its record \$6,357,000 in 1972.

The Administration's decision in July 1973 to delay releasing the price ceilings for retail beef until mid-September caused a back-up of saleable cattle in feedlots throughout the country. When cattle feeders finally began marketing their cattle in September, fat cattle prices declined by 26% in a period of less than two months due to an excessive supply of marketable cattle. As prices were beginning to improve in January 1974, the independent truckers' strike forced curtailment of purchases by packers, which prolonged the price recovery.

Mesa follows the normal practice of valuing its cattle inventory at the lower of cost or market for financial reporting purposes. For year-end 1973, the carrying value of Agro's cattle inventory was adjusted by \$4,496,000 to reflect lower fat cattle and futures prices on February 27, 1974. This reduced Agro's 1973 operating income below previous expectations. Fat cattle and futures prices have continued to decline, and restoration of profitable operations cannot be expected before current excess supplies are consumed.

Financial

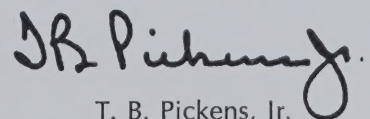
On April 30, 1973 Mesa acquired Pubco Petroleum Corporation for 1,440,344 shares (after two-for-one split) of common stock. The combining of the two companies has been most beneficial.

In September, the Board of Directors declared a two-for-one stock split which was paid on December 7, 1973 to shareholders of record on November 12, 1973. The Board also authorized an increase in the common stock from 12 million to 20 million shares, which was approved by the shareholders at a special meeting in November 1973.

In December, 2,218,900 shares of newly-issued common stock were sold to the public. Merrill Lynch, Pierce, Fenner & Smith Incorporated and Donaldson, Lufkin & Jenrette Securities Corporation managed the sale of the stock, which was participated in by substantially every major brokerage firm in the U.S. and several foreign firms. Three insurance companies which, in conjunction with the Series A and C loans, had previously received warrants to purchase Mesa common stock, sold 218,900 shares of the stock offered. Mesa received approximately \$72 million from sale of the common stock and exercise of the warrants by the insurance companies, which proceeds were used to reduce corporate indebtedness. According to an article in the February, 1974 issue of the *Institutional Investor*, Mesa's offering was the second largest primary equity offering in the nation during 1973 and the tenth largest offering in the past ten years.

In summary, Mesa has made timely investments in an outstanding inventory of domestic oil and gas leases covering numerous prospects from the Gulf of Mexico to Canada. Our drilling results during 1973 reflect favorably on the ability of our excellent staff to originate oil and gas prospects and provide a basis for substantial drilling opportunities in 1974 and beyond. The equity offering in 1973 strengthened the Company's financial position and will enable us to capitalize on the current strong demand for energy and to accelerate our growth. Although the price structure of domestic petroleum products remains to be finalized, Mesa's opportunity for continued growth in 1974 is most favorable.

Sincerely,



T. B. Pickens, Jr.

March 25, 1974

Exploration and Development

The backbone of a successful exploration program is the acreage inventory. Mesa has aggressively added to its holdings of undeveloped oil and gas leases for several years and is in excellent position to capitalize on the more realistic prices for oil and natural gas. The Company's current

undeveloped leases total 5.4 million net acres compared to 3.7 million net acres in 1972 and 2.2 million net acres in 1971. The Company drilled 140.6 net (228 gross) wells in 1973, of which 88.8 encountered hydrocarbons (63%); this compares to 81.0 net wells drilled in 1972 with 34.2 successful (42%). Wildcat success for 1973 was 46% compared to 17% for 1972. Additions to proved reserves were approximately 185% of the company's annual production for 1973. The Company has budgeted \$60 million for exploration and development expenditures for 1974, excluding lease acquisition costs.

Gulf Coast Division

Exploration and development continues offshore Louisiana and Texas where Mesa has an average of 23.5% interest in 30 tracts.

December 1970 Sale — At year-end, East Cameron 270 produced at the rate of 415 million cubic feet of gas and 1900 barrels of condensate per day, and production from Eugene Island 330

UNDEVELOPED ACREAGE

December 31, 1973

	Gross Acres	Net Acres
United States		
Alabama	7,753	4,073
Alaska	20,413	18,229
California	11,520	518
Colorado	223,473	204,008
Florida	265,060	120,568
Kansas	35,872	34,078
Louisiana	86	4
Michigan	729	729
Mississippi	8,568	6,145
Montana	211,331	194,250
Nebraska	1,280	1,280
New Mexico	106,991	87,185
North Dakota	122,755	106,212
Oklahoma	29,979	22,456
South Dakota	1,758	1,758
Texas	66,972	54,764
Utah	98,624	85,329
Wyoming	236,162	219,322
Offshore Louisiana & Texas	156,746	50,108
Canada		
Alberta (1)	1,793,562	1,275,178
Arctic Islands (1)	762,946	762,946
British Columbia (1)	969,968	285,609
Northwest Territories (1) ...	1,121,321	436,570
Ontario	19,937	1,994
Saskatchewan (1)	669,094	550,013
International		
North Sea (U.K.)	524,000	135,200
North Sea, W. German Sector (1) (2)	1,420,000	470,000
Gabon (1) (2)	500,000	147,500
Ghana (1) (2)	696,720	124,016
Totals	10,083,620	5,400,042

(1) Includes drilling reservations, petroleum and natural gas reservations, permits, leases, licenses and conventions.

(2) Working interest must be earned by certain exploration activities.

DRILLING ACTIVITY

	1973		1972	
	Gross	Net	Gross	Net
Exploratory Wells				
Productive	42	26.4	11	8.6
Dry	48	30.9	66	41.3
	90	57.3	77	49.9
Development Wells				
Productive	106	62.4	81	25.6
Dry	32	20.9	9	5.5
	138	83.3	90	31.1
TOTAL	228	140.6	167	81.0

rose to 22,000 barrels of oil and 22 million cubic feet of gas per day. It is anticipated that production from Eugene Island 330 will increase steadily throughout 1974 as development drilling progresses and by year-end should reach approximately 50,000 barrels of oil per day. Exploratory wells drilled in prior years on Vermilion 228 and Eugene Island 256 encountered hydrocarbons, and in light of more favorable prices, these tracts now are under consideration for development.

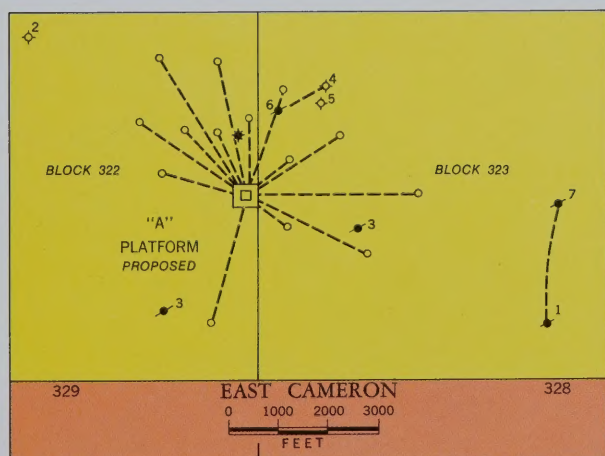
September 1972 Sale — The presence of hydrocarbons has been established on South Pass 78, and engineering studies are underway for the design of a platform suitable for this area of the Gulf. Plans for development of this tract are awaiting the conclusion of these studies and the outcome of drainage sales expected in the latter part of 1974.

December 1972 Sale — Exploration on the nine tracts acquired in this sale is progressing more slowly than desired due to a shortage of drilling equipment. Two discoveries have been announced on Eugene Island 333, and the first of two platforms was installed in October 1973. By year-end, two development wells had been drilled from this platform. The second platform should be ready for installation in July 1974. Exploratory drilling has been emphasized on Eugene

Island 333, since there are four offsetting drainage tracts scheduled for the March 1974 lease sale. A platform for East Cameron 322 is scheduled for installation in April 1974. Production from the platforms on Eugene Island 333 and East Cameron 322 should commence late in 1975.

June 1973 Sale — Exploration through February, 1974, on seven of the 14 blocks acquired offshore Texas resulted in hydrocarbons being found on five tracts. At the present stage of exploration, platforms are under consideration on three of the five blocks. Seven tracts remain to be drilled and several of the tested tracts will require additional exploratory wells before their commercial capabilities can be determined.

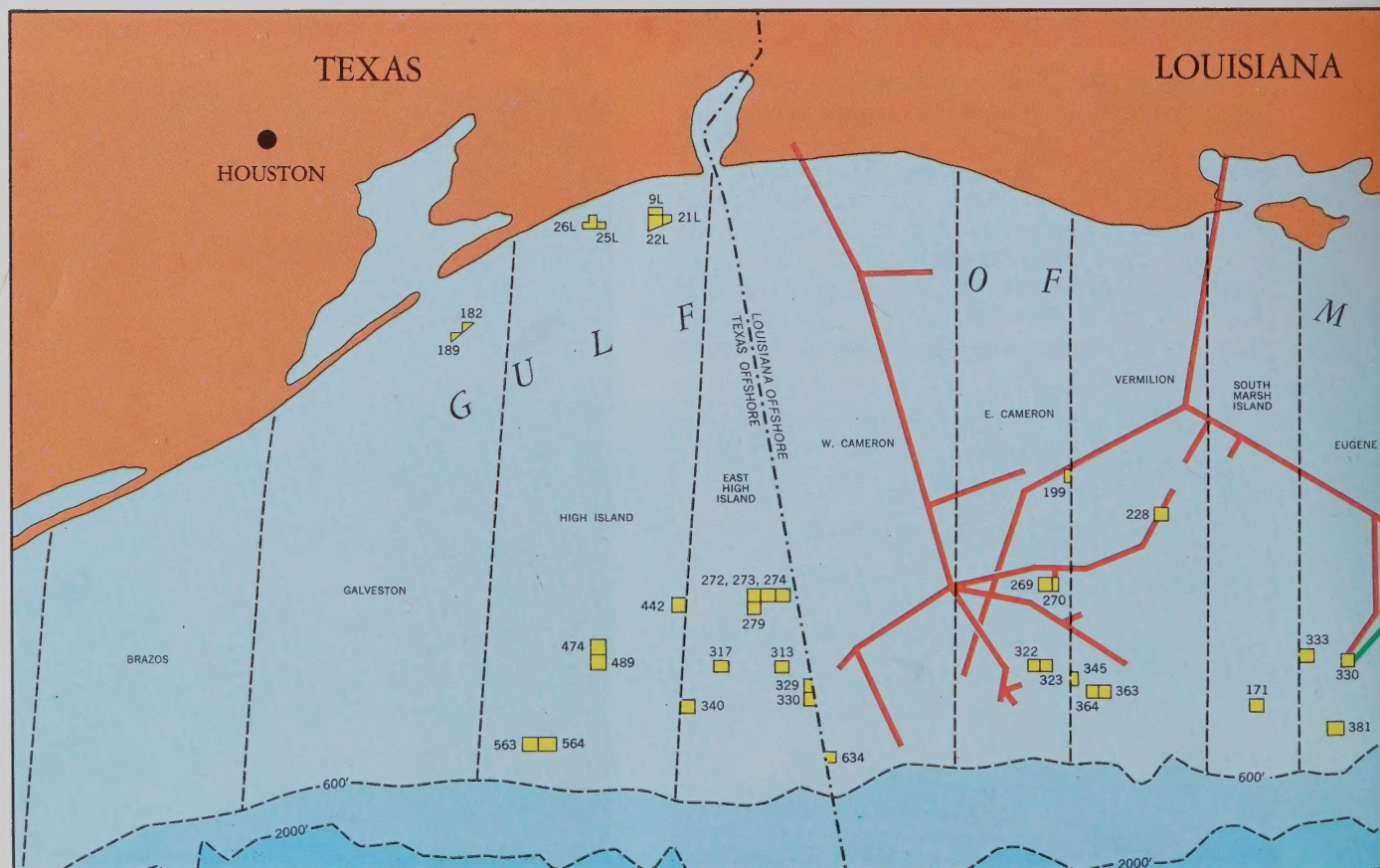
Walkway between the production platform and Drilling Platform "C" on Eugene Island Block 330.



Lease Sale-Area and Block	Gross Lease Bonus (Millions)	Mesa's		Exploratory Wells Drilled or Drilling (1)(2)	Platforms		Development Wells Drilled or Drilling(2)
		Interest	Lease Bonus (Millions)		Announced	Installed	
December 1970	Eugene Island 256 ..	\$ 16.2	16.77%	\$ 4.9	5	1	
	Eugene Island 330 ..	28.3	5.00%	1.4	8½	3	62(3)
	Vermilion 228	3.6	43.29%	1.5	2½		
	East Cameron 199 ...	2.1	68.43%	.6	1		
	East Cameron 270 ..	32.2	5.00%	1.6	3	2	35(4)
September 1972	South Pass 78	15.1	25.00%	3.8	3	1	
December 1972	Eugene Island 333 ..	61.5	13.33%	8.2	3	1	
	Eugene Island 381 ..	2.2	25.00%	.5	1		
	S. Marsh Island 171 ..	8.1	24.00%	2.3	—	1	2
	Vermilion 345	9.6	24.00%	2.3	1½		
	Vermilion 363	15.8	46.00%	7.3	1		
	Vermilion 364	6.6	46.00%	3.0	—		
	East Cameron 322 ..	28.8	48.00%	13.8	3		
	East Cameron 323 ..	33.8	48.00%	16.2	8		
June 1973	West Cameron 634 ..	6.6	50.00%	3.3	2		
	East Cameron 269 ..	1.5	5.00%	.1	—		
	High Island 272	17.9	15.00%	2.7	1		
	High Island 273	44.6	15.00%	6.6	3		
	High Island 274	15.1	15.00%	2.2	—		
	High Island 279	11.4	15.00%	1.6	—		
	High Island 313	16.2	30.67%	5.0	—		
	High Island 317	77.7	12.27%	9.5	—		
	High Island 329	5.1	10.00%	.5	—		
	High Island 330	17.6	18.40%	3.2	1		
	High Island 340	31.4	25.00%	7.8	—		
	High Island 442	34.7	15.00%	5.1	2		
	High Island 474	37.7	15.00%	5.6	3	1	
	High Island 489	57.1	15.00%	8.5	—		
	High Island 563	61.7	5.66%	3.5	—		
	High Island 564	32.8	5.66%	1.9	—		
TOTAL	\$733.0		23.52% (Av)	\$134.5			

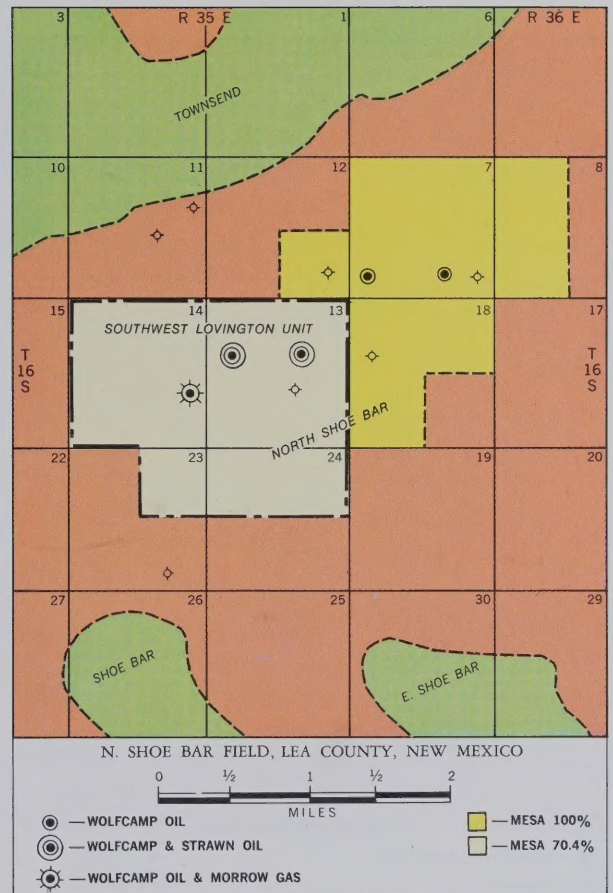
ERRATA: In the December 1972 lease sale, the platforms and development wells listed for S. Marsh Island 171 should have been shown for Eugene Island 333. The announced platform listed for Eugene Island 333 should have been shown for East Cameron 322. There had been no activity on S. Marsh Island 171.

(1)Lease line wells shown as ½ well. (2)As of 12/31/73. (3)Includes 24 dual completions. (4)Includes 11 dual completions.



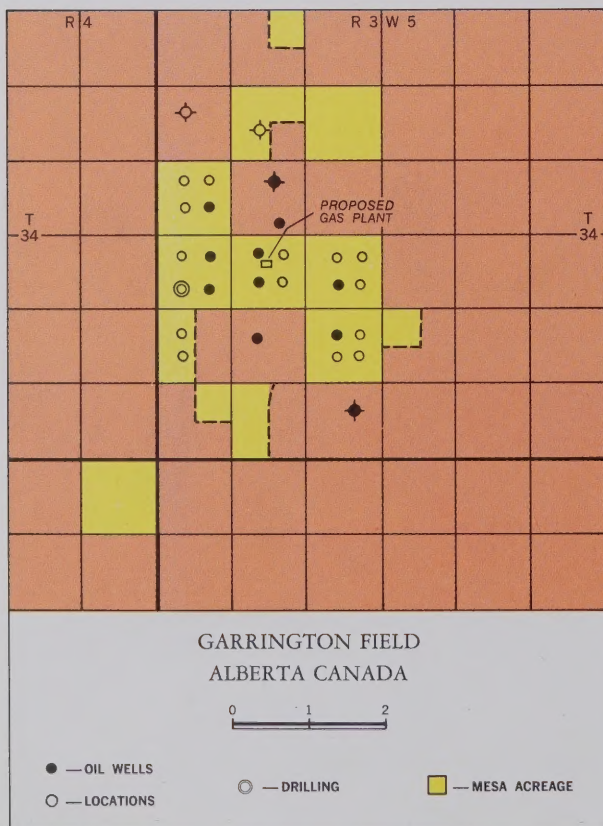
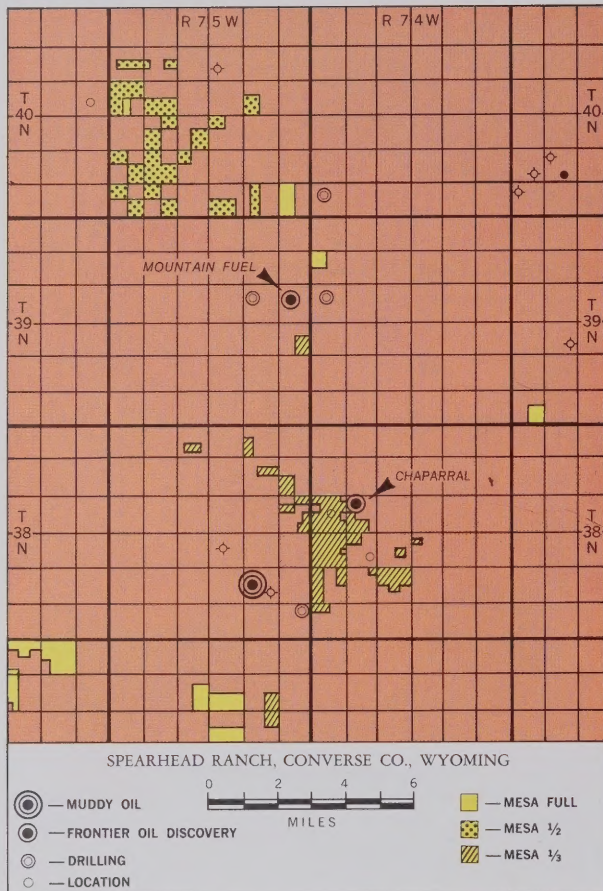
Permian Basin Division

This division, acquired in the Pubco merger, made a significant discovery of oil and gas in the North Shoe Bar field (Southwest Lovington Unit) New Mexico where we have three Wolfcamp oil wells, two Strawn oil wells and a Morrow gas completion. The Company is actively developing its acreage in the field. Production from these wells will approximate 2,500 barrels of oil and 5 million cubic feet of gas per day commencing early in the second quarter of 1974. Development drilling also continues in the Humble City field (Southwest Knowles area) and in the Southeast Carlsbad field area, where two gas wells were completed in 1973.



Production platform facilities on Eugene Island Block 330.





Central Division

The Central Division was moved to Denver and now includes Pubco's Rocky Mountain operation. Mesa participates in the Steinle Ranch Unit in the Powder River Basin of Wyoming and has 100% working interest in one of seven wells in this rapidly expanding new field which came on production in March of 1974. Most wells in the field have initial productive capacities of 1,000 barrels of oil per day. In the Powder River Basin, Mesa will participate in several development wells in the Spearhead Ranch Area where Mountain Fuel and Chaparral have found oil and gas production in the Frontier sand.

Canadian Division

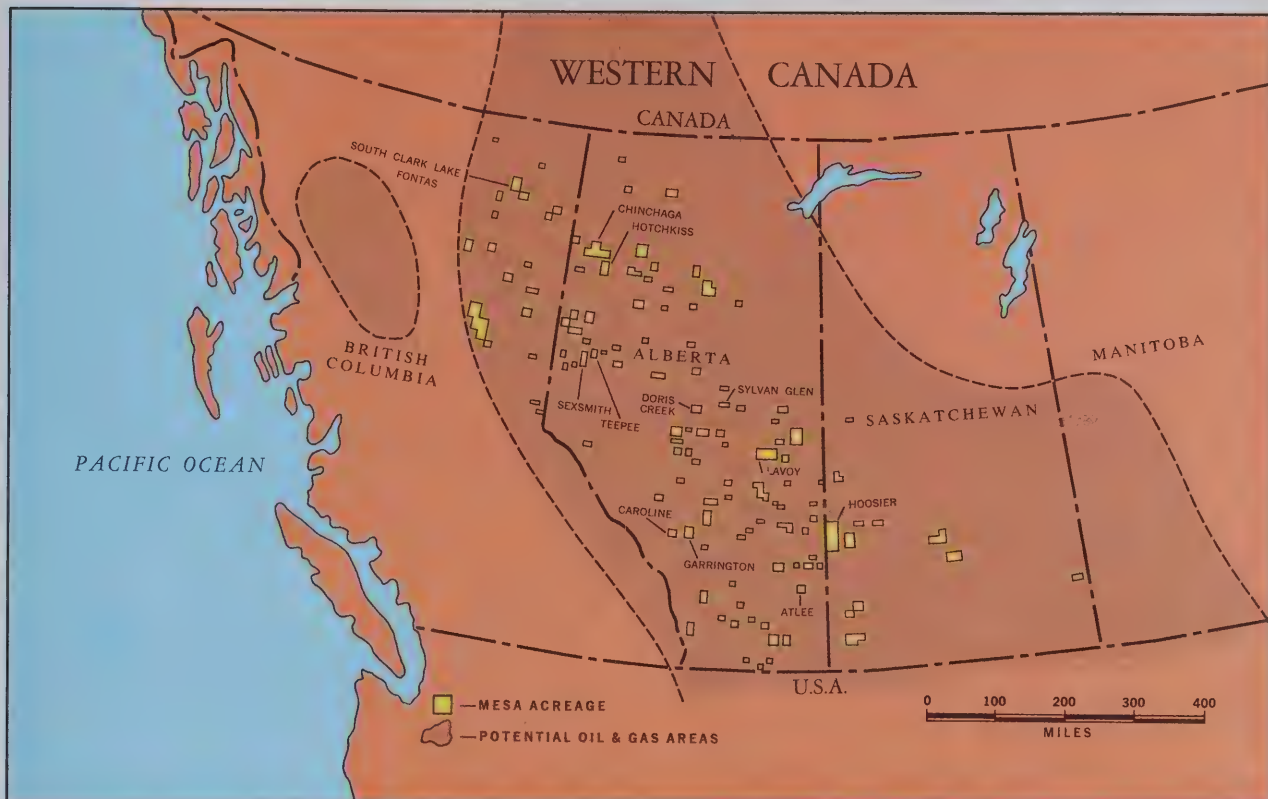
Mesa's 1973 exploratory drilling in Canada was very successful, with numerous discoveries of both oil and gas. Activity was concentrated in such areas as Lavoy, Sylvan Glen, Doris Creek, Hotchkiss, and Chinchaga in Alberta, South Clarke Lake and Fontas in British Columbia, and Hoosier in Saskatchewan. A number of the wells completed in 1973 are gas producers which are expected to be on-stream by late 1975. Production from the new oil wells will commence by mid-1974.

Mesa received approval for 160-acre spacing in the Garrington field where we own 90% working interest in 7000 acres. Eight wells have been completed in the Glauconite zone and an additional 15-well development drilling program is in progress with completion scheduled for the fourth quarter of 1974. By the end of 1974, production from the Garrington field should increase from 350 barrels of oil and 2 million cubic feet of gas per day to 1000 barrels of oil and 5 million cubic feet of gas.

We believe that certain provinces in Canada will continue to provide some of the more favorable areas for exploration. The Company's exploratory and development activities in Saskatchewan, however, will await further clarification of the province's petroleum policies. The Canadian Division's 1974 operations will be concentrated in the statistically favorable gas and oil areas of Alberta and the Devonian reef trends of Alberta and British Columbia.

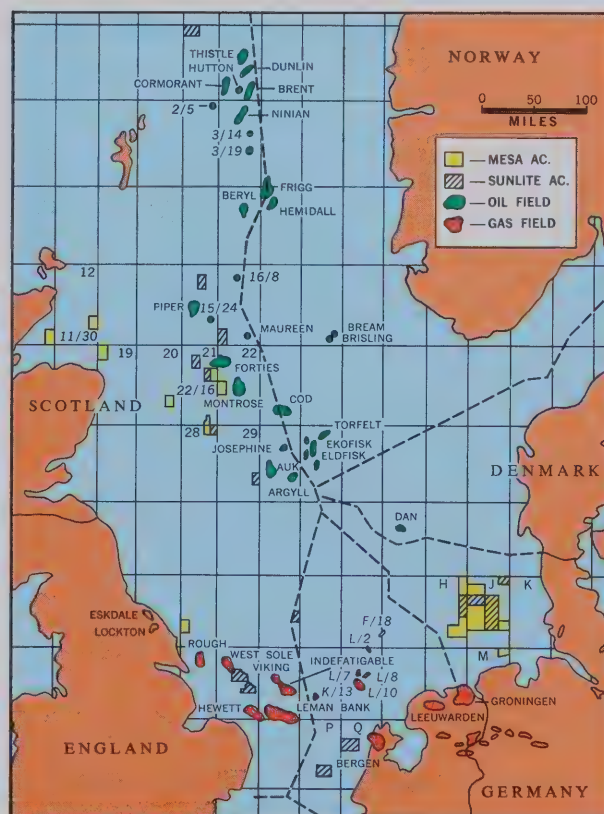
International Division

Our activities in this Division consist of finalizing plans for drilling in the North Sea, evaluating further potential in West Africa, and seeking new opportunities in favorable areas elsewhere in the world.



In the United Kingdom sector of the North Sea, we have agreed with partners to drill wildcat wells in Block 11/30 (Mesa 25%) and in Block 22/16 where our group (Mesa 25%) shares a highly prospective structure with Amoco et al, who will operate and share the costs of the well. This drilling is scheduled for early 1975, but will commence as soon as equipment is available. Plans are being finalized for a work program in the German sector of the North Sea where we can drill and earn 25% interest in 950,000 acres to add to our 50% interest in 260,000 acres earned by previous expenditures in this sector.

In March 1974, Mesa agreed to invest \$3.9 million over a two-year period to acquire a 19% interest in Sunlite Oil Company Limited. Mesa also received a one-year option to acquire additional stock to bring its interest to 55%. The Boards of Directors of both companies have approved the agreement; and, subject to compliance with applicable Canadian and U.S. laws and regulations, the transaction should be finalized shortly. Sunlite owns producing oil and gas properties in Western Canada and Louisiana and undeveloped leases from the Arctic to the South-eastern U.S. Of significant importance, Sunlite owns interests ranging from 5% to 10% in 23 undeveloped leases in the United Kingdom, German and Dutch sectors of the North Sea, representing 106,125 net acres.



Production and Reserves

PRODUCTION

The upward trend in the Company's production of oil and natural gas continued throughout 1973. Mesa's daily net production in 1973 averaged 271 million cubic feet of gas and 4,197 barrels of oil, an increase of 6% and 12% respectively over 1972. Production of natural gas liquids in 1973 averaged 3,688 barrels per day, a decline of 12% from volumes produced in 1972 due to lower processed gas sales to The Kansas Power and Light Company from the Hugoton field, Kansas. In December 1973, average daily net production amounted to 4343 barrels of oil, 4527 barrels of natural gas liquids, and 321 million cubic feet of gas.

Oil and gas production showed improvement throughout the year, with substantial increases being realized from the Canadian and Gulf Coast areas. Continued gains are expected during 1974 due to development drilling, and a full year's production from properties recently placed on-stream. For 1973, natural gas sales accounted for 68% of total oil and gas revenues, while oil and natural gas liquids represented 32%.

Natural Gas

Mesa's net natural gas production in 1973 totaled 98.8 billion cubic feet, compared with 92.5 billion cubic feet in 1972. Through normal declines in allowables, warmer weather in the Fall of 1973

PRODUCTION SUMMARY

	Year Ended December 31				
	1973	1972	1971	1970	1969
Net Natural Gas					
Produced (Mcf) (1)	98,798,119	92,470,862	84,538,926	56,826,200	53,610,112
Daily Average (Mcf)	270,680	253,345	231,614	155,688	146,877
Net Natural Gas Liquids					
Produced (Bbls) (2)	1,345,733	1,530,127	1,319,519	688,041	688,932
Daily Average (Bbls)	3,688	4,192	3,615	1,885	1,887
Net Crude Oil (including condensate)					
Produced (Bbls) (1)	1,531,552	1,363,771	1,560,188	1,864,767	1,917,233
Daily Average (Bbls)	4,197	3,737	4,275	5,109	5,253
Weighted Average Price for Production:					
Gas—Sales Price per Mcf	\$.232	\$.208	\$.196	\$.187	\$.190
Natural Gas Liquids—Sales Price per Bbl	\$3.50	\$2.57	\$2.48	\$2.06	\$1.72
Oil—Sales Price per Bbl	\$3.77	\$3.00	\$3.01	\$2.83	\$2.79

(1) Net of interests of others but including amounts attributable to production payments sold to others as follows: 1969, 15,097 Bbls, and 401,430 Mcf; and 1973, 22,661,448 Mcf.

(2) Net of interests of others but including an amount attributable to a production payment of 430,929 Bbls sold in 1973.

and energy conservation measures, sales to KP&L from the Hugoton field declined from 78.2 billion cubic feet in 1972 to 70.4 billion cubic feet in 1973. With the signing of the amendment to the KP&L contract in late 1973, sales of accumulated excess allowable gas to KP&L in 1974 should offset any further decline in sales under the regular contract provisions. The single most significant addition to natural gas sales in 1973 resulted from start-up of gas sales from the two platforms on East Cameron 270 in February and May. Mesa's net production had risen to 18 million cubic feet of gas per day from these platforms at year-end.

A one-time sale of 7.5 billion cubic feet of excess allowable gas was made to Panhandle Eastern Pipe Line Company from the Hugoton field during the year.

Natural Gas Liquids

Natural gas liquid production was 1,346,000 barrels in 1973 compared to 1,530,000 barrels in 1972. Production declined 12% in 1973 as a result of lower processed gas sales to KP&L from the Hugoton field. The one-time gas sale to Panhandle Eastern involved non-processed gas and did not result in additional natural gas liquid production to Mesa.

Crude Oil

Mesa's net crude oil production increased 12% to 1,532,000 barrels in 1973, versus 1,364,000 barrels in 1972. The 1973 results reversed a three-year trend of declining oil production which reflected primarily the peaking and subsequent decline of production from the Sleepy Hollow waterflood property acquired in the merger with Pubco. The principal increase in oil production came from Eugene Island 330 which went on-stream in the first quarter of 1973. Mesa's daily net production averaged 835 barrels of oil from this tract since production commenced in March 1973 and increased to 900 barrels at year-end. Following completion of development drilling in late 1974, Mesa's net production is expected to increase to approximately 2000 barrels of oil per day.

The upward trend of crude oil production is expected to continue in 1974. In addition to a full year of increased production from Eugene Island 330, net production of 1650 barrels of oil

per day from five oil completions in the North Shoe Bar field is scheduled to commence in the second quarter. An additional 900 barrels of net oil production, representing Mesa's interest in the Steinle Ranch Unit, went on-stream in March 1974. Development of Mesa's acreage will continue in both of these fields. The development activity in the Garrington field will add approximately 600 barrels per day net to Mesa's interest.

RESERVES

As a result of our successful drilling program in 1973, approximately 5 million barrels of oil (including condensate and natural gas liquids) and 200 billion cubic feet of gas were discovered. These additions do not include reserves from offshore tracts. These new reserves amount to approximately 175% of oil and 200% of gas production in 1973. Mesa's net proved reserves at year-end are summarized in the following table:

NET PROVED RESERVES	Oil*	Gas
	(Thousands of Barrels)	(Billion Cubic Feet)
Net proved reserves as of July 1, 1973, as estimated by DeGolyer and MacNaughton, independent petroleum engineers	35,298	1,787
Add — new reserves discovered since July 1, 1973, as estimated by Company engineers	3,644	89
Deduct — Production from July 1, 1973 to December 31, 1973	(1,541)	(50)
Net proved reserves as of December 31, 1973	<u>37,401</u>	<u>1,826</u>

* Includes condensate and natural gas liquids.

The above reserve data includes proved reserves for High Island 22-L and offshore tracts East Cameron 270 and Eugene Island 330. As of December 31, 1973 proved reserves of 3.8 million barrels of oil and condensate and 220 billion cubic feet of gas were not contributing to income. These reserves will be put on production when markets and pipeline connections become available.

Prices

As a result of the energy shortage, the government has imposed restrictions on the price of "old" oil and condensate. Specific regulations with respect to the allocation of natural gas liquids and oil also have been put into effect. Although these orders and regulations frequently have been amended, they currently limit the price of "old" production established prior to 1973 to \$5.25 per barrel or less and generally require that natural gas liquids and oil be sold to the same purchaser which purchased these products during a previous "base period". These regulations limit the price Mesa can receive for its liquid hydrocarbon production and preclude our negotiating with various third parties to receive the full value for our products. Realistically, in order to increase exploration, these regulations should be discontinued to allow domestic producing companies a price for their production competitive with prices received in the world markets.

A part of our Canadian gas production is sold to pipeline companies under long-term contracts for the eventual resale in the United States by such pipeline companies. The exportation of Canadian natural gas and its importation into the United States is subject to regulation by Canadian Authorities and the FPC, respectively. In addition, the National Energy Board, a Canadian Federal Governmental Agency, has imposed an "export tax" (payable by the pipeline exporter) on crude oil exported from Canada. This "export tax" is determined periodically by the National Energy Board and basically is the difference between the price of oil in the Chicago area and the price in Canada. Also, the Dominion Government has frozen the price of oil at the wellhead (in Mesa's producing area, this is approximately \$4.00 per barrel). This price freeze is scheduled to be in effect through March, 1974.

In Alberta, where a major portion of Mesa's Canadian acreage is located, the Provincial Government has recently increased the royalty on natural gas produced; however, there has also been an increase in the wellhead price for the gas. The overall result is that producing companies will realize approximately 25% more for natural gas.

In Saskatchewan, the Provincial Government has passed Bill No. 42, The Oil and Gas Conservation, Stabilization and Development Act, 1973, which further limits the price a producer

can receive for oil produced in Saskatchewan. Mesa is currently receiving \$4.05 per barrel from the purchaser; however, the amount in excess of \$2.57 (Basic Wellhead Price) is paid as tax. This Basic Wellhead Price will be determined periodically by the Provincial Government. We understand that the Government is formulating regulations to provide incentives for exploration by giving credit for certain amounts spent on exploration which could increase the effective price of oil. Bill No. 42 is being contested in the courts by others, and Mesa is paying the tax under protest.

In British Columbia, a Provincial corporation (British Columbia Petroleum Corporation), has been organized to become the sole purchaser of gas in the province. The corporation proposes to acquire all existing gas purchase contracts and in exchange will pay governmental royalties and increase the wellhead price of the gas. Under this arrangement the value received by the producing companies for the gas will be increased approximately 80%.

In October, 1973, Mesa and The Kansas Power & Light Company amended their contract covering the sale of natural gas from Mesa's properties in the Hugoton field in Kansas. Under the amendment, 1) Mesa will sell to KP&L 33 billion cubic feet (Bcf) of accumulated "excess" gas from the Hugoton field during 1973 through 1976 at a rate of approximately 8 Bcf each year, 2) Mesa will use its best efforts to supply to KP&L an additional 75 Bcf of new gas during 1977 through 1982 at volumes of up to 15 Bcf annually and 3) the price to be paid for the gas delivered under the existing contract extending through 1989 will be increased 7 cents per Mcf beginning January 1, 1974 and an additional 2 cents per Mcf beginning January 1, 1975. The final price to Mesa will depend upon the volume of new gas delivered to KP&L. The amended contract has been approved by the Kansas Corporation Commission, which governs intrastate sales in Kansas. Negotiations for delivery of the 75 Bcf of new gas to KP&L are underway. Should delivery involve an interstate transaction, the contract will require approval by the Federal Power Commission. Until Mesa is confident its obligations under the contract can be met, the additional 7¢ per Mcf price increase will be treated as deferred income for financial reporting purposes. "Excess" gas production during the year will, however, be booked at 34.8¢ per Mcf as provided for in the amended contract and reported as current income.

Agribusiness

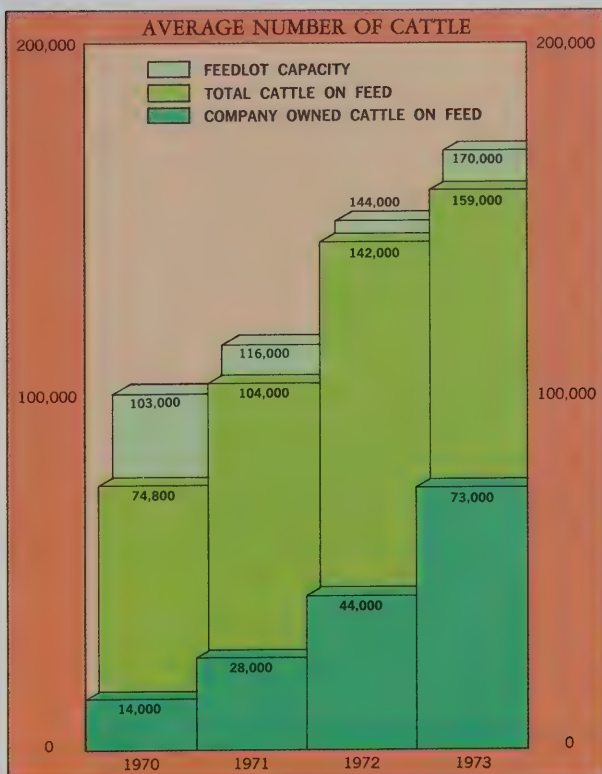
The Mesa Agro Division completed its second most profitable year in 1973 with net operating income of \$4,176,000 compared to \$6,357,000 for 1972. Agro's earnings resulted from a 94% utilization of its one-time feedlot capacity of 170,000 head of cattle plus sale of 121,000 head of company-owned cattle compared to 82,000 head sold in 1972.

Many factors contributed to bring about wide fluctuations in fat cattle prices during the year. The cattle-feeding industry saw prices climb to record levels of 46¢ per pound in the first quarter of 1973, then experienced a 10% decline in response to the much-publicized consumer meat boycott in April. Following resumption of normal cattle sales, the Administration, under consumer pressure, next imposed a ceiling on retail meat which equated to about a 47¢ per pound price for fat cattle in the feedlots. In mid-July, price ceilings for all meats, except beef, were released and a mid-September date was established for

eliminating controls on beef prices. In the interim, cattle feeders had little incentive to market fat cattle in anticipation of substantially higher prices in September. Packers and retailers, in order to maintain nominal supplies of meat during this period, cut profit margins and paid prices up to 54¢ per pound for limited numbers of cattle. Such higher prices reinforced the cattle feeders' decision to hold marketable fat cattle into September. The backlog of heavier weight cattle, coupled with normal high fall seasonal supplies of feedlot cattle, exceeded market demand to the extent that fat cattle prices fell to below 40¢ per pound, a 26% decline, in less than 60 days.

The excess supply situation continued to depress fat cattle markets until late in December and early January when prices returned to the 50¢ per pound level. These prices were short-lived, however, due partly to the independent truckers' strike in February. Packers, unable to move fresh meat to markets, restricted purchases for several weeks, causing another backlog of marketable cattle still somewhat out of balance from 1973. By late February, 1974 when Agro's books were closed for 1973, prices had declined again to approximately 45¢ per pound, necessitating a \$4,496,000 reduction in the carrying value of Agro's year-end cattle inventory and an accompanying reduction in Agro's earnings for 1973 below previously anticipated levels. The adjusted carrying values of the inventory become the cost basis for sale of the cattle remaining in inventory at year-end.

These severe price reductions for cattle during the past six months have eroded significant amounts of equity from the cattle-feeding industry at a time when more funds are needed to increase long term supplies of beef and counteract inflationary pressures. While the continued current price weakness precludes any possibility of profitable first quarter operations for Agro, the temporary over supply of fat cattle should decline to more manageable levels in the second quarter. The remainder of 1974 is encouraging for several reasons—feeder cattle and grain prices have declined recently, which will improve cattle-feeding margins, and lower placements in feedlots for the past twelve months should result in improved fat cattle markets as the year progresses.



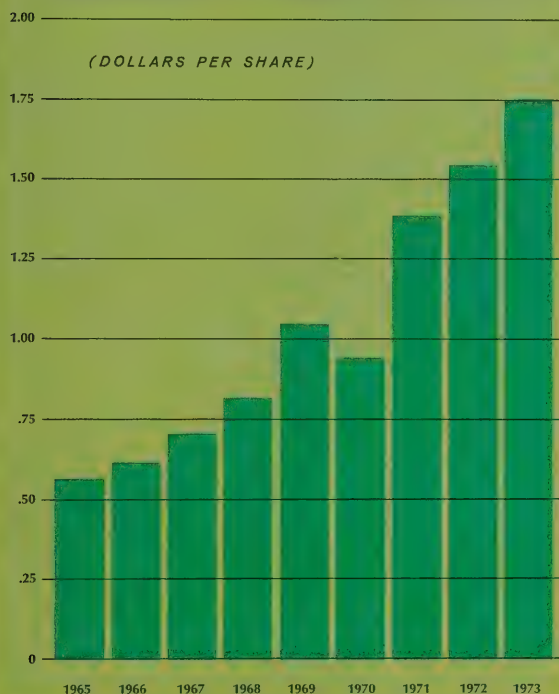


(1) Peter M. Clarke—V.P. Canada. (2) CENTRAL DIVISION: Jed W. Lemmons—Division Landman; J. Roland Everett—Division Geophysicist; Robert W. King—Division Manager. (3) PERMIAN BASIN DIVISION: Robert H. Northington—Division Landman; Marion E. Causey—Division Manager; Joe W. Jeffers—Sr. Geologist. (4) CANADIAN DIVISION: Dennis L. Kolesar—Operations Manager; Desmond J. Murphy—Production Foreman; John J. Nadurak—Production Supervisor. (5) CANADIAN DIVISION: James L. Hudson—Exploration Manager; James A. Bruce—Sr. Geologist; D. K. Bruce Fenwick—Geophysicist; Ronald Carlyon—Sr. Geologist. (6) James L. Farrell—Operations Superintendent/Central & Permian Basin Division; Glenn C. Smith—Manager Exploration/International Division. (7) CANADIAN DIVISION: John M. Gareau—Land Manager; Brian C. Gillard—Landman; Kenneth P. Murphy—Landman. (8) MESA AGRO: Thomas W. Herrick—President; Ronald D. Bassett—Controller; James D. Man—Vice President; Robert L. Bliss—Vice President. (9) Dennis L. Kolesar—Operations Manager/Canada; C. Taylor Yoakam—Manager, Gas Sales & Contracts.

Financial Review

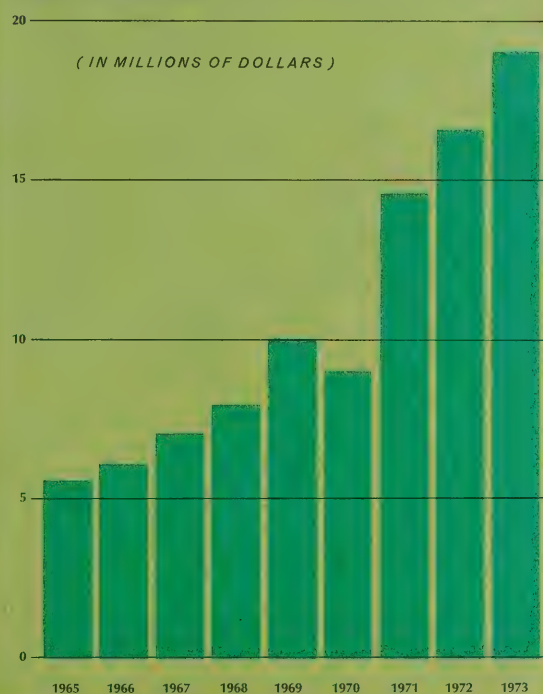
EARNINGS PER SHARE

EXCLUDING EXTRAORDINARY ITEMS

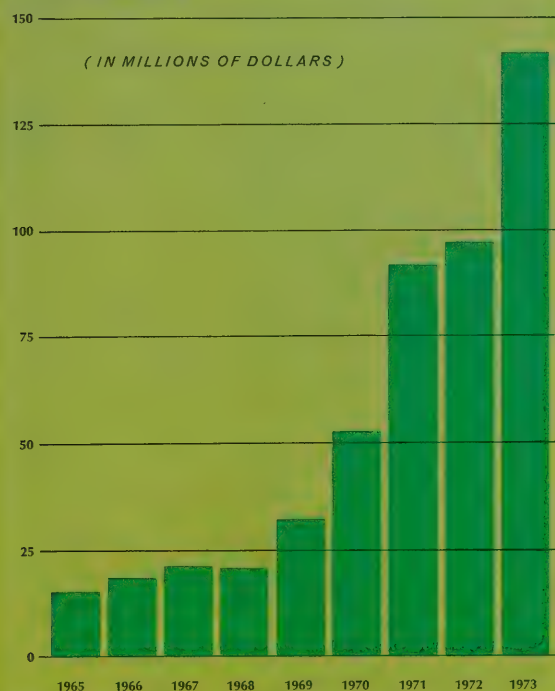


NET INCOME

EXCLUDING EXTRAORDINARY ITEMS

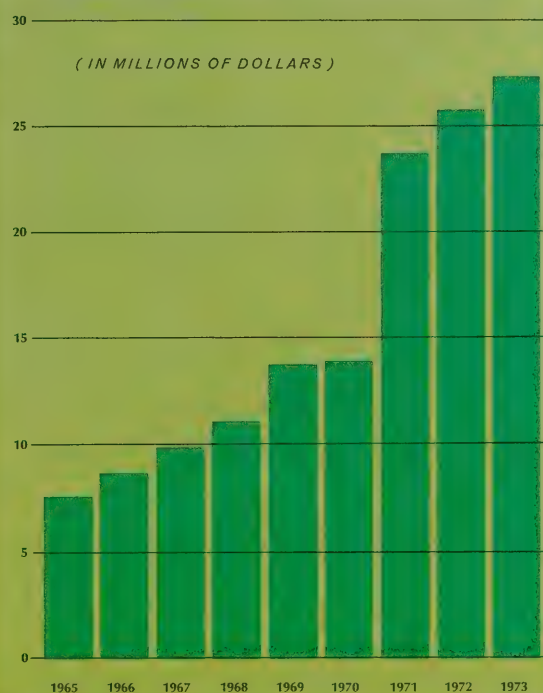


REVENUES



CASH FLOW

EXCLUDING EXTRAORDINARY ITEMS



Consolidated Balance Sheet

December 31, 1973 and 1972

ASSETS

	1973	1972
CURRENT ASSETS:		
Cash (Note 2)	\$ 9,525,468	\$ 11,382,050
Trade accounts and notes receivable	12,273,665	7,879,334
Inventories (Notes 1 and 2) —		
Feed, grain, and cattle	46,488,927	21,027,447
Other	2,841,675	369,928
Prepaid expenses	290,305	200,543
Total current assets	<u>\$ 71,420,040</u>	<u>\$ 40,859,302</u>
INVESTMENTS, at cost	<u>\$ 943,497</u>	<u>\$ 931,128</u>
PROPERTY, PLANT AND EQUIPMENT, at cost (Notes 1 and 2):		
Oil and gas properties, wells and equipment	\$169,784,271	\$135,122,204
Offshore oil and gas properties not yet evaluated by drilling. . .	135,850,110	61,034,143
Grain and cattle feeding facilities	9,486,390	6,837,099
Automotive, office, and other properties	3,093,683	2,719,681
	<u>\$318,214,454</u>	<u>\$205,713,127</u>
Less — Accumulated depreciation, depletion, and amortization	45,444,951	34,768,765
	<u>\$272,769,503</u>	<u>\$170,944,362</u>
EXCESS OF COST OF COMPANIES ACQUIRED OVER EQUITY IN NET TANGIBLE ASSETS AT DATE OF ACQUISITION, not being amortized (Note 1)	<u>\$ 5,967,422</u>	<u>\$ 6,266,987</u>
DEFERRED CHARGES AND OTHER ASSETS:		
Issue expense on long-term debt, net of amortization	\$ 1,616,312	\$ 1,606,253
Cash surrender value of life insurance	331,653	276,762
Deposits and deferred charges	346,843	139,242
	<u>\$ 2,294,808</u>	<u>\$ 2,022,257</u>
	<u>\$353,395,270</u>	<u>\$221,024,036</u>

(See accompanying notes to consolidated financial statements)

LIABILITIES

	1973	1972
CURRENT LIABILITIES:		
Current maturities on long-term debt	\$ 4,913,632	\$ 3,026,022
Short-term notes payable (Note 2)	17,994,383	12,509,466
Accounts payable	17,489,547	10,724,228
Accrued liabilities —		
Interest	3,189,165	1,073,017
Taxes, other than income taxes	451,110	543,028
Accrued income taxes	—	1,167,400
Total current liabilities	<u>\$ 44,037,837</u>	<u>\$ 29,043,161</u>
LONG-TERM DEBT (Note 2)	\$ 81,584,062	\$ 94,794,789
Less — Current maturities	4,913,632	3,026,022
	<u>\$ 76,670,430</u>	<u>\$ 91,768,767</u>
ADVANCE ON GAS TO BE DELIVERED IN THE FUTURE (Note 3)	\$ 42,750,000	\$ —
DEFERRED FEDERAL INCOME TAXES (Note 1)	\$ 4,306,083	\$ 4,871,573
CONTINGENT LIABILITIES and COMMITMENTS (Notes 6 and 7)		
STOCKHOLDERS' INVESTMENT (Notes 2, 4 and 5):		
Preferred stock, \$1 par value, issuable in series, 1,000,000 shares authorized — \$2.20 cumulative convertible senior preferred stock, outstanding 441,002 and 548,479 shares, respectively (liquidating preference of \$33,075,150 at December 31, 1973)	\$ 441,002	\$ 548,479
Common stock, \$1 par value; authorized 20,000,000 shares; outstanding 10,974,700 and 4,126,071 shares, respectively ...	10,974,700	4,126,071
Warrants to purchase 201,300 and 210,100 shares of common stock, respectively	682,245	1,591,500
Capital surplus	110,476,351	43,019,835
Reinvested earnings	63,056,622	46,054,650
	<u>\$185,630,920</u>	<u>\$ 95,340,535</u>
	<u><u>\$353,395,270</u></u>	<u><u>\$221,024,036</u></u>

(See accompanying notes to consolidated financial statements)

Consolidated Statement of Income

For the Years Ended December 31, 1973 and 1972

	1973	1972
OIL AND GAS OPERATIONS:		
Revenues —		
Natural gas	\$ 22,872,958	\$ 19,278,647
Oil and natural gas liquids	10,480,266	8,027,349
Other income	288,292	608,643
	<u>\$ 33,641,516</u>	<u>\$ 27,914,639</u>
Expenses —		
Operating expenses	\$ 3,103,550	\$ 2,506,620
Interest	2,171,452	1,396,245
Taxes, other than on income	1,061,042	1,056,139
Depreciation, depletion, and amortization (Note 1)	8,568,834	6,856,069
	<u>\$ 14,904,878</u>	<u>\$ 11,815,073</u>
Net operating income	<u>\$ 18,736,638</u>	<u>\$ 16,099,566</u>
CATTLE OPERATIONS:		
Feed, grain, and cattle sales	<u>\$108,222,893</u>	<u>\$ 69,530,580</u>
Expenses —		
Cost of feed, grain, and cattle (Note 1)	\$ 94,582,944	\$ 57,664,300
Operating expenses	4,645,990	3,121,952
Taxes, other than on income	215,936	159,261
Interest	3,827,004	1,603,636
Depreciation and amortization (Note 1)	774,948	624,157
	<u>\$104,046,822</u>	<u>\$ 63,173,306</u>
Net operating income	<u>\$ 4,176,071</u>	<u>\$ 6,357,274</u>
TOTAL NET OPERATING INCOME	\$ 22,912,709	\$ 22,456,840
General and administrative expenses	4,808,609	3,505,237
Income before federal income taxes	\$ 18,104,100	\$ 18,951,603
Federal income taxes (Note 1) —		
Current	—	559,000
Deferred	(1,000,000)	1,741,000
NET INCOME	<u>\$ 19,104,100</u>	<u>\$ 16,651,603</u>
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE (Note 1)	<u>\$1.75</u>	<u>\$1.55</u>

(See accompanying notes to consolidated financial statements)

Consolidated Statements of Reinvested Earnings and Capital Surplus

For the Years Ended December 31, 1973 and 1972

	1973	1972
REINVESTED EARNINGS		
Balance, beginning of year, as previously reported	\$ 27,032,665	\$ 28,164,138
Adjustment to reflect the acquisition of Pubco Petroleum Corporation on a pooling-of-interests basis	19,021,985	18,179,556
Balance, beginning of year, as restated	\$ 46,054,650	\$ 46,343,694
Net income for the year	19,104,100	16,651,603
Cash dividends —		
Common stock	(421,541)	(321,639)
Pubco common stock prior to merger	(583,338)	(583,338)
Preferred stock	(1,097,249)	(1,259,141)
10% stock dividend	—	(14,776,529)
Balance, end of year	<u>\$ 63,056,622</u>	<u>\$ 46,054,650</u>
CAPITAL SURPLUS		
Balance, beginning of year, as previously reported	\$ 31,894,663	\$ 16,626,036
Adjustment to reflect the acquisition of Pubco Petroleum Corporation on a pooling-of-interests basis	11,125,172	11,051,147
Balance, beginning of year, as restated	\$ 43,019,835	\$ 27,677,183
Stock options exercised (Note 5)—		
Mesa	930,714	856,081
Pubco prior to merger	560,615	74,025
Conversion of preferred stock	(340,037)	(66,360)
Redemption of preferred stock	—	35,200
Cancellation of shares previously issued in acquisition of feedyard company	(290,150)	—
Excess market value over par value of common stock issued in connection with the 10% stock dividend	—	14,443,706
Warrants exercised (Note 2)	4,267,610	—
Excess market value over par value of common stock sold in 1973, net of \$3,546,165 expenses of sale	66,453,835	—
Two-for-one stock split (Note 1)	(4,126,071)	—
Balance, end of year	<u>\$110,476,351</u>	<u>\$ 43,019,835</u>

(See accompanying notes to consolidated financial statements)

Consolidated Statement of Changes in Financial Position

For the Years Ended December 31, 1973 and 1972

	1973	1972
SOURCE OF FUNDS:		
Net income	\$ 19,104,100	\$ 16,651,603
Depreciation, depletion, and amortization	9,343,782	7,480,226
Deferred Federal income taxes	(565,490)	2,920,199
Funds provided from operations	\$ 27,882,392	\$ 27,052,028
Long-term borrowings and sale of production payment	96,815,661	62,259,549
Net proceeds from sale of stock	68,453,835	—
Proceeds from exercise of warrants	3,577,255	—
Proceeds from exercise of stock options —		
Mesa	986,345	879,002
Pubco	576,669	90,475
Sale of properties	4,513,017	227,666
Redemption of preferred stock	—	35,200
Net decreases (increases) in investments and other assets	(284,923)	1,105,816
	<u>\$202,520,251</u>	<u>\$ 91,649,736</u>
USE OF FUNDS:		
Capital expenditures —		
Oil and gas properties, wells and equipment	\$112,467,283	\$ 84,163,173
Grain and cattle feeding facilities	2,657,575	815,708
Other properties	557,082	1,051,025
Retirement of long-term debt and production payment	67,276,387	4,349,355
Cash dividends	2,102,128	2,164,115
Payment for fractional shares of stock	6,124	31,876
	<u>\$185,066,579</u>	<u>\$ 92,575,252</u>
Increase (decrease) in working capital exclusive of current maturities on long-term debt —		
Cash	\$ (1,856,582)	\$ 1,792,710
Notes and accounts receivable	4,394,331	(1,435,717)
Inventories	27,933,227	8,397,871
Prepaid expenses	89,762	42,058
Short-term notes payable	(5,484,917)	(4,982,621)
Accounts payable, accrued liabilities and income taxes ...	(7,622,149)	(4,739,817)
	<u>\$ 17,453,672</u>	<u>\$ (925,516)</u>
	<u>\$202,520,251</u>	<u>\$ 91,649,736</u>

(See accompanying notes to consolidated financial statements)

Notes to Consolidated Financial Statements

December 31, 1973 and 1972

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES —

Principles of consolidation —

The consolidated financial statements include the accounts of the parent, Mesa Petroleum Co. and its wholly-owned subsidiaries after elimination of significant intercompany transactions. There are no differences between the Company's cost of investment in its subsidiaries and its equity in the net assets of such subsidiaries.

The consolidated financial statements for 1972 have been restated to reflect on a pooling-of-interests basis the acquisition of Pubco Petroleum Corporation on April 30, 1973 in exchange for 1,440,344 shares of common stock. Gross revenues and net income for both companies for the calendar year 1972 were as follows:

	<u>Revenues</u>	<u>Net Income</u>
Mesa	\$91,605,000	\$15,226,000
Pubco	5,853,000	1,439,000
Total*	<u>\$97,458,000</u>	<u>\$16,665,000</u>

* Before elimination of dividend income of Mesa applicable to its investment in Pubco amounting to \$13,000.

The excess cost of the cattle feeding, grain, and cattle companies acquired by the Company in 1969 over the value of the net tangible assets of such companies at date of acquisition is carried as an intangible asset in the accounts and will not be amortized unless a diminution in its value becomes evident.

Oil and gas properties and depreciation —

The Company, as did Pubco Petroleum Corporation, follows the accounting policy of capitalizing, for financial purposes, all direct costs incurred in the acquisition, exploration, and development of gas and oil properties, including dry hole and other nonproductive costs. Such capitalized costs, exclusive of offshore oil and gas properties not yet evaluated by drilling, are being amortized on a company-wide composite unit-of-production method over the aggregate productive life of all of its producing properties. The costs of offshore oil and gas properties (\$135,850,000 as of December 31, 1973) are not included in the property base for depletion and amortization purposes until such time as they are evaluated by drilling. As each offshore lease tract is evaluated by drilling, the lease costs, together with all applicable drilling and exploration costs, are transferred to the oil and gas property base for depletion and amortization purposes. For those tracts which are initially indicated to be nonproductive, the transfer to the property base would normally occur after the drilling of two to four wells. However, when oil and gas is discovered on a tract, the drilling of ten or more wells might be required before a reasonably accurate estimate of recoverable reserves can be made in order to transfer the tract to the property base for depletion and amortization purposes. Assuming the availability of drilling equipment and material, the Company anticipates that substantially all offshore tracts acquired would be evaluated and transferred to the property base within eighteen to twenty-four months of the respective dates of acquisition of the tracts. The Company follows the policy of transferring all of the costs of a tract to the

property base once a productive reservoir is established and evaluated even though subsequent exploration may discover additional reserves. Likewise, a tract initially evaluated by drilling as non-productive and transferred to the property base may later prove to be productive by subsequent exploration. The Company first acquired offshore oil and gas tracts in December, 1970, at which time interests in five tracts were acquired. During 1971, two of these tracts were evaluated by drilling as nonproductive and transferred to the property base and during 1972 the remaining three tracts were evaluated and transferred to the property base. West Cameron Tract 634, acquired in December, 1972, was evaluated by drilling as nonproductive during 1973, and transferred to the property base. Offshore oil and gas properties transferred to the property base for the years 1971, 1972, and 1973 were \$9,746,000, \$7,687,000, and \$4,306,000, respectively.

No gains or losses are recognized upon the sale or disposition of oil and gas properties, except in extraordinary transactions. Interest on indebtedness incurred with respect to offshore leases is capitalized as part of nonproducing oil and gas leases in instances where money has been specifically borrowed to acquire the leases. As of December 31, 1973, such capitalized interest amounted to \$6,588,000 of which \$6,560,000 was incurred during 1973.

Direct costs associated with the exploration for and development of gas and oil reserves for the year ended December 31, 1973, and the amount of such costs remaining on the balance sheet at December 31, 1973, are summarized below.

<u>Description</u>	<u>Year Ended December 31, 1973</u>	<u>Balance December 31, 1973</u>
Lease acquisition costs (including interest)	\$ 79,081,062	\$167,535,938
Geological and geophysical costs	2,721,793	15,566,491
Drilling expenditures	28,774,596	100,487,465
Lease rentals	1,952,296	12,198,486
Plant and equipment	5,767	9,846,001
	<u>\$112,535,514</u>	<u>\$305,634,381</u>

The Company's average sales price and rate of depreciation, depletion and amortization of oil and gas properties per Mcf and equivalent Mcf for the years ended December 31, 1972, and 1973 are as follows:

	<u>Average Per Mcf and Equivalent Mcf</u>	
	<u>Sales Price</u>	<u>Depreciation, Depletion and Amortization</u>
1972	\$.233	\$.058
1973273	.066

Depreciation of grain and cattle feeding facilities and other equipment is provided on the straight-line method at the following rates:

Office furniture and fixtures	10%
Automotive equipment	20-33⅓ %
Buildings, machinery, and equipment	10-12½ %
Grain and cattle feeding facilities	5-12½ %

It is the practice of the Company to charge maintenance and repairs against income when incurred. Renewals and betterments which extend the useful life of the equipment are capitalized.

Federal income taxes —

Deferred taxes are provided by the Company to the extent taxes are currently reduced due to timing differences between taxable and financial income on accelerated depreciation of various

facilities and equipment, certain cattle inventory costs and certain leasehold costs including interest capitalized on offshore leases. Deferred taxes applicable to intangible drilling and exploration costs, which are capitalized for financial reporting purposes as discussed above and are deducted as incurred for income tax purposes, will be provided if the unamortized capitalized costs of such properties should ever exceed the estimated future income tax deductions attributable thereto.

In 1973, intangible drilling and exploration costs and statutory depletion exceeded income before Federal income taxes which resulted in a reduction of \$1,000,000 in deferred taxes provided in 1972. Set forth below is a reconciliation of the reported income tax expense and the amount of tax computed by multiplying the income before Federal income tax by the U.S. Federal income tax rate of 48%:

	<u>Amount</u> <u>(in thousands)</u>	<u>% of</u> <u>Pretax</u> <u>Income</u>
Taxes computed by applying statutory rate	\$ 8,690	48 %
Increases (decrease) in taxes resulting from:		
Excess of intangible drilling and exploration costs deducted for tax purposes over amortization for financial purposes .	(7,883)	(44)
Excess of statutory tax depletion over depletion of producing leasehold cost for financial purposes	(1,952)	(11)
Minimum tax on tax preference items	429	2
Other — net	(284)	(1)
	<u>\$ (1,000)</u>	<u>(6) %</u>

At December 31, 1973, the Company has a tax net operating loss carryforward of approximately \$12,000,000 available to offset future taxable income through 1978. The tax benefits from such loss carryforward will be credited to the deferred Federal income tax liability account when utilized.

Inventories and Cattle and Grain Futures —

Cattle inventories are stated at the lower of actual cost (excluding interest) or market. At December 31, 1973, the Company owned 125,000 head of cattle, of which 66,000 head were in the Company's feedlots and 59,000 head were on pasture for future delivery to the Company's feedlots. In addition, as of December 31, 1973, the Company had entered into feeding arrangements, as described in Note 6, with feedlot customers relating to 48,000 head of cattle whereby the Company guarantees these customers against losses in excess of certain amounts. Based on the applicable cattle market prices on February 27, 1974 and sales of cattle through that date, the Company provided for estimated losses of \$4,500,000 on its cattle inventory and guaranty feeding arrangements existing as of December 31, 1973 by reducing its inventory carrying values and charging cost of cattle sales.

In order to substantially eliminate fluctuations in the sales price of fat cattle for its own account, the Company at times partially or wholly hedges its inventory of cattle by selling cattle futures contracts on the commodity exchange. The cattle futures contracts are repurchased at approximately the same time the cattle are sold. The Company sometimes purchases cattle futures contracts on the commodity exchange when the costs of such cattle contracts are less than the estimated cost to acquire and feed cattle. In addition, the Company at various times purchases grain futures contracts as a hedge against increases in the cost of grain fed to its cattle. As a result of the foregoing transactions, net operating income from feed, grain and cattle operations was decreased by \$599,000 in 1972 and increased by \$6,688,000 in 1973. On December 31, 1973, the Company owned futures contracts for the purchase of approximately 6,800 head of cattle at 45¢ per pound, and had 14,000 head of its cattle in the feedlots hedged at an average sales price of 49¢ per pound.

Other inventories are stated at average cost which is not in excess of market.

Earnings per share —

Earnings per share have been computed based upon the weighted average number of common shares outstanding during each period (10,915,000 in 1973 and 10,740,000 in 1972) adjusted for the 10% stock dividend in June 1972, the two-for-one stock split in December 1973, and assuming conversion of all preferred stock and exercise of stock options and warrants which have a dilutive effect.

(2) **SHORT-TERM NOTES PAYABLE AND LONG-TERM DEBT —**

Short-term notes payable at December 31, 1973 include \$16,875,000 of notes payable to banks, which bear interest at annual rates from 9% to 10.8% and are secured by grain and cattle inventories and receivables from sales of cattle.

The Company has a \$43 million revolving short-term line of credit, evidenced by a note bearing interest at 110% of the prime rate, to finance the requirements of its commercial feedlot operations and to finance the purchase and feeding of cattle for its own account. At December 31, 1973, \$11,900,000 was outstanding under such credit agreement at an interest rate of 10.8%. The approximate average aggregate borrowing under such agreement during 1973 amounted to \$23,476,000 on which the approximate weighted average interest rate was 8.1%. The maximum amount outstanding on all short-term loans during 1973 amounted to \$46,000,000. The Company has agreed to maintain compensating balances amounting to 10% of the above line of credit plus from 10% to 23% of the lines of credit of certain feedyard customers whose debt is guaranteed by the Company. At December 31, 1973, approximately \$7 million of compensating balances were being maintained.

Long-term debt and other obligations at December 31, 1973, and current maturities are as follows:

	<u>Long-Term</u>	<u>Current</u>	<u>Total</u>
8% secured notes, Series "A", due 1985	\$10,000,000	\$1,000,000	\$11,000,000
10½ % secured note, Series "B", due 1975 . . .	1,375,000	1,375,000	2,750,000
9¼ % secured notes, Series "C", due 1986 . . .	8,845,000	770,000	9,615,000
Noninterest-bearing secured note due 1981 . . .	40,000,000	—	40,000,000
Noninterest-bearing secured note payable from production, if any, or beginning in 1978 . . .	6,400,000	—	6,400,000
Noninterest-bearing secured note, payable quarterly beginning in 1975	5,838,000	—	5,838,000
Noninterest-bearing unsecured note, payable from production beginning in 1974, with unpaid balance due in 1976	3,384,000	1,616,000	5,000,000
Other	828,430	152,632	981,062
	<u>\$76,670,430</u>	<u>\$4,913,632</u>	<u>\$81,584,062</u>

The eight percent Series "A" notes due 1985 were issued to three institutional lenders, along with 10-year warrants for the purchase of 200,200 shares of common stock of the Company at \$20.45 per share. The Company has the option to purchase the warrants at \$22.73 per warrant at any time prior to May 31, 1979. The Series "B" note due 1975, which was issued to a bank, bears interest at the rate of one-half percent above the bank's prime rate. The 9¼ percent Series "C" notes due 1986 were issued during 1971 to four institutional lenders, along with 10-year warrants for the purchase of 220,000 shares of common stock of the Company at \$15 per share. The Company has the option to purchase the warrants at \$22.73 per warrant at any time prior to September 30, 1980. During 1973, warrants to purchase 53,900 (Series "A" warrants) and 165,000 (Series "C" warrants) shares of common stock, respectively, were exercised for an

aggregate consideration of \$3,577,255, leaving 146,300 of the Series "A" warrants and 55,000 of the Series "C" warrants outstanding at December 31, 1973. Under the mortgage indenture relating to the Series "A", Series "B", and Series "C" notes, the Company has pledged its Hugoton field oil and gas properties. The mortgage agreement stipulates that the Company maintain unconsolidated current assets in excess of unconsolidated current liabilities, as defined, and may incur additional indebtedness, not junior to the mortgage notes, only under certain conditions.

In May, 1973, the Company obtained an interest-free \$40 million exploration and development loan from a major gas transmission company. The loan is secured by a first mortgage on certain of the Company's oil and gas properties in New Mexico and Colorado, and is repayable in five annual installments, as follows: \$6 million one year after initial production of gas from certain offshore Louisiana Federal leases or May 18, 1977, whichever is earlier, and four successive annual installments thereafter of \$7 million, \$8 million, \$9 million, and \$10 million, respectively. The lender has the right to purchase the Company's portion of any gas production that is developed on any of the above Federal offshore leases at a minimum of 50 cents per Mcf or any higher interstate price approved by the Federal Power Commission at the time commercial reserves are developed.

In September, 1973, the Company executed an agreement with a major gas transmission company whereby the Company granted the transmission company an option to purchase its share of all gas discovered and produced from an offshore Louisiana Federal lease. In return, the transmission company agreed to make an interest-free \$6,400,000 exploration and development loan to the Company. The loan is secured by a first mortgage on the offshore property and is repayable in five annual installments as follows: \$384,000 one year after initial delivery of gas from the property, but no later than January 1, 1978, and four successive annual installments thereafter of \$448,000, \$448,000, \$1,920,000 and \$3,200,000, respectively.

(3) ADVANCE ON GAS TO BE DELIVERED IN THE FUTURE —

In January, 1973, the Company sold a \$45 million production payment out of its producing gas properties in the Hugoton field in Kansas which production payment is subordinate to the Series "A", Series "B", and Series "C" secured notes. The production payment is payable quarterly at the rate of \$3 million annually during 1973 and \$6 million annually thereafter or from 100% of production, whichever is less, and bears interest at a rate equal to 130% of the lending bank's prime rate plus 1/16 of 1%. The revenues from the sale have been deferred for financial reporting purposes and are being taken into income as the gas is produced.

(4) COMMON STOCK AND PREFERRED STOCKS —

Changes in the number of shares of the Company's common and preferred stocks for the year ended December 31, 1973, are set forth below:

	<u>Common</u>	<u>\$2.20 Senior Preferred</u>
Shares outstanding, beginning of year, as previously reported . .	3,418,995	548,479
Shares issued for Pubco, treated as a pooling-of-interests	707,076	—
Shares outstanding, beginning of year, as restated	4,126,071	548,479
Two-for-one stock split	4,126,071	—
Conversion of \$2.20 senior preferred stock	443,257	(107,477)
Stock options exercised —		
Mesa	53,039	—
Pubco	26,192	—
Cancellation of shares previously issued	(18,830)	—
Warrants exercised	218,900	—
Sale of common stock	2,000,000	—
Shares outstanding, end of year	<u>10,974,700</u>	<u>441,002</u>

Each share of the \$2.20 cumulative convertible senior preferred stock is entitled to one vote per share and preferential annual cash dividends of \$2.20 per share, is convertible into 4.125 shares of common stock until March 1, 1974, and 3.52 shares thereafter, is entitled to preferential payment of \$75 per share on liquidation, and is redeemable at \$85 per share until March 1, 1974, and \$75 per share thereafter. The conversion rates have been adjusted for the two-for-one common stock split paid in December, 1973.

(5) STOCK OPTIONS —

The 1965 and 1969 qualified stock option plans and 1970 nonqualified stock option plan authorize the granting of options for 546,260 shares of common stock at prices equivalent to market value at date of grant. The options become exercisable in four annual installments commencing one year after the date granted and if not exercised, expire five years after the date of grant as to the qualified options and 10 years after date of grant on the nonqualified options. Upon exercising of options, the Company credits the capital stock account with the par value of the shares purchased and credits the balance of the cash received to capital surplus and no charge is made to income. As of December 31, 1973, options for 236,975 shares were outstanding at prices ranging from \$13.90 to \$40.56 per share. During the year ended December 31, 1973, options for 53,039 shares were exercised at prices ranging from \$13.90 to \$27.28. All prices per share and the number of shares have been adjusted to reflect the two-for-one common stock split paid in December, 1973.

(6) CONTINGENT LIABILITIES AND COMMITMENTS —

The Company has entered into cattle feeding arrangements with certain feedyard customers, whereby the Company guarantees these customers against losses in excess of certain amounts. In certain of these feeding arrangements, the Company receives a percentage of the net profits realized by the customers on cattle sales. In addition, at December 31, 1973, the Company was contingently liable as guarantor of approximately \$16,000,000 of debts of these feedyard customers and others.

During the period from August to December, 1973, Mesa publicly offered and sold limited partnership interests resulting in the formation of five cattle feeding limited partnerships with aggregate subscriptions of \$5,280,450. The partnerships formed pursuant to such offering will operate for at least two feeding cycles, after which the limited partners have the right to withdraw. In connection with this offering, investors purchased options requiring Mesa to purchase interests of the limited partners at prices ranging from 76 percent to 86 percent of original cost, resulting in Mesa's having total possible repurchase obligations of \$3,941,511.

As of December 31, 1973, the Company was committed to purchase grain aggregating approximately \$4,500,000 (which represents the feedyards normal supply) and to purchase cattle aggregating approximately \$1,000,000.

(7) SUBSEQUENT EVENT —

In February, 1974, the Company agreed in principle with Sunlite Oil Company, Ltd. to acquire over a two-year period 564,881 shares of Sunlite common stock yet to be issued for \$3,900,000. Such purchase would represent 19% of Sunlite's then outstanding shares. The Company also has a one year option to purchase 2,435,119 additional common shares at \$10 per share, bringing its ownership of Sunlite to 55%.

Auditors' Report

To the Stockholders and Board of Directors,

MESA PETROLEUM CO.:

We have examined the consolidated balance sheet of Mesa Petroleum Co. (a Delaware corporation) and subsidiaries as of December 31, 1973 and 1972, and the related consolidated statements of income, reinvested earnings, capital surplus, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Mesa Petroleum Co. and subsidiaries as of December 31, 1973 and 1972, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

ARTHUR ANDERSEN & CO.

Houston, Texas
February 27, 1974



Standing, (L to R) Gene Edwards, Henry D. Lindsley, III, R. S. Smith, J. O. Upchurch, F. R. Davis, John F. Boros, J. K. Larsen, Gaines L. Godfrey. Seated, (L to R) Michael A. Nicolais, Robert L. Stillwell, T. B. Pickens, Jr., Wales H. Madden, Jr.

DIRECTORS

Gene Edwards
Henry D. Lindsley III
Wales H. Madden, Jr.
Michael A. Nicolais
T. B. Pickens, Jr.
Richard S. Smith
Robert L. Stillwell

TRANSFER AGENTS

Common Stock

The Chase Manhattan Bank (N.A.)
The First National Bank of Amarillo

Preferred Stock

Irving Trust Company

REGISTRARS

Common Stock

The Chase Manhattan Bank (N.A.)
First City National Bank of Houston

Preferred Stock

The Chase Manhattan Bank (N.A.)

AUDITORS

Arthur Andersen & Co.
Houston, Texas

COUNSEL

Baker & Botts
Houston, Texas

OFFICERS

T. B. Pickens, Jr., *President and Chairman of the Board of Directors*
Wales H. Madden, Jr., *Chairman of the Executive Committee*
Jack K. Larsen, *Group Vice President*
Peter M. Clarke, *Vice President-Canada*
Frank R. Davis, *Vice President-Operations*
John E. Stobart, *Vice President-International*
James O. Upchurch, *Vice President-Engineering*
John F. Boros, *Secretary and Treasurer*

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Amarillo, Texas 79105

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